DDI-695-74

8 March 1974

MEMORANDUM

South Vietnam's Aid Requirements

Summary

Recent declines -- in real terms -- in US aid to South Vietnam are setting the stage for losses in living standards that could radically alter that nation's economic and social order. Furthermore, these shortfalls cannot be overcome by more vigorous short-term "bootstrapping." At the end of this decade, South Vietnam will still have an annual requirement for aid and foreign investment from all sources (mostly US) on the order of $1 billion (1974 prices). The record, in even the very best of growth cases, makes it clear that South Vietnam as we know it today will need large sums of aid for another 15 years or more. Ambassador Martin's recent cables on aid requirements are reasonable to us within this context, although we doubt that our economic goals in South Vietnam can be met through a few years' intensive effort.

I. The Impact of Global Inflation on Aid and Economic Conditions

We estimate that South Vietnam will need on the order of $1 billion in foreign aid and investment in 1974 to support modest economic growth. In reality, it will probably receive only about $800 million (including PL 480 assistance and official piaster purchases) with nearly all of this coming from US official sources. This will represent less actual aid than in 1971 because of global price increases in the interim. Indeed, 1971's $700 million of aid would cost about $1.2 billion to replace today.

As the real value of our aid has declined since 1971, South Vietnam has been faced with major new requirements for reconstruction, refugee assistance, and food shortages. This decline has coincided as well with:

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-- major reform programs that, in the short run, tended to slow economic growth;

-- large-scale withdrawal of US personnel and attendant declines in their spending;

-- a major military offensive that depressed industry and commerce; and

-- bad weather that halted agricultural growth.

As might be expected, significant gains in Vietnamese savings and taxes notwithstanding, investment sank unusually low and the economy stagnated in 1973. The outlook for 1974 is for further declines in real incomes.

There is very little fat in the Vietnamese economy despite frequent press citations of the "Honda" economy. Real wages of government employees (civilian and military) have fallen to about two-thirds of last year's level. For wage earners, expenditures for rice alone probably now account for more than one-half of their income. Recently, those Vietnamese who could afford them have been buying bicycles at close to $100 each to replace motor vehicles, with gasoline now at an astronomical $1.50 per gallon. Goods we regard as necessities (such as clothing and books) have been flushed out of the import bill through extremely high special duties. About two-thirds of the consumer goods imported in 1973 was food, to offset the results of the preceding year's poor harvest. We estimate that there is no more than $50 million that can be squeezed out of imports, now largely raw materials and capital equipment, without driving domestic production or food consumption further downward.

II. Policy Options

There are few policy options for the Vietnamese in this economic setting. The first and, remarkably, the easiest is to make a strenuous effort to elicit aid from non-US sources. They have done this with increasing vigor over the past year, but the gap

between current US annual aid and what is needed for rapid growth is clearly out of the range of likely support for the next 2-3 years.* No country has ever proceeded faster with major institutional changes in savings, taxes, commercial procedures, or exchange rates than South Vietnam; and there is no magic tool to stimulate the private sector that remains unused. If the situation continues to deteriorate, the next departure in economic policies will likely be the return of extensive direct controls, a system we and our Vietnamese counterparts labored hard to remove through the 1971-73 reforms in order to stimulate private-sector growth.

III. The Martin Proposals

Reflecting in part an understanding of what was involved in the 1971-73 declines in real US aid levels, Ambassador Martin has sent a number of cables in from South Vietnam to request:

- -- a supplemental authorization of $250 million for FY 1974; and
- -- US aid level of $850 million (excluding PL 480 and piaster purchases) for FY 1975.

So far, these requests are consistent with our own estimates of the aid required to achieve even modest real growth, assuming no major hostilities. The supplemental for FY 1974 was intended to simply regain ground lost to inflation after the San Clemente meetings. Now the Ambassador is attempting to secure enough aid to cover trend requirements, including some makeup for the amounts lost through failure to adequately adjust for dollar price increases for imports in 1972-73.

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* Total non-US aid in 1973 amounted to $50 million and is expected to double in 1974. However, all of such aid last year was tied to particular projects worked out with the donors and could not be flexibly used to support private-sector needs. Of the projected $100 million in 1974, $40 million is expected to be available for commodity imports.

The outlook for meeting these needs is bleak. Considering that the supplemental request for $250 million for fiscal 1974 has been converted into a proposal for $54 million to go before Congress, the economy will probably not grow adequately to avert declines in real incomes this year. Moreover, given other US commitments in Indochina, there is scant prospect for a program that would support $850 million of US official aid in FY 1975.

IV. Aid Needs Over the Longer Run

Despite broad agreement on aid requirements for recovery and growth over the next few years, there is one very important difference between our conclusions and those of the Ambassador and AID. We simply cannot believe that overall aid requirements for moderate growth -- or the US share of them -- will decline significantly during the next five years. Given the low base from which South Vietnam begins, the attainment of steady economic growth is not simply the product of one big "shot" of capital. No country in circumstances similar to that of South Vietnam today has ever come close both to sustaining growth and covering its trade deficit through exports and "normal" capital inflows in less than 15 years.

We estimate that South Vietnam will not have moved significantly beyond the sort of living standard that obtained when we began our massive military and economic aid in the mid-1960s unless it has received annual foreign capital inflows on the order of $1 billion (1974 prices) through the rest of this decade. The prospects for accelerating the pace of recovery and expansion to shorten the period of client status for South Vietnam are not good. Barring major oil discoveries, it is unlikely that South Vietnam can become relatively independent of large-scale foreign aid until well into the 1980s.

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